RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 23 DJIA 3757.72; PTI 4037; A-D Ratio -2.99
Dec. 31 DJIA 3754.09; PTI 4038; A-D Ratio -2.44
Dow Yield: 2.68%; Dow Price/Earnings: 36.7
Dow 200-day MA: 3552; Dow 30-day MA: 3715
Dow Times Book Value: 3.27; PTI 89-day MA: 3984
Percentage of Undervalued Blue-chips: 8%
Dow Low Risk Buy Index: +110; Gold-PTI: 1113

THE PICTURE: The following section describes a scenario that I've been mulling over, but one that I haven't wanted to write about -- until now. The basic thesis came to me because I've noticed (as you undoubtedly have) that this stock market continues to creep, creep, creep higher -- but all the while the prevailing sentiment on Wall Street and Main Street is one of pessimism, suspicion and doubt.

And I ask myself, "Do big bull markets end with careful, creeping-up action? Do big bull markets end amid skepticism and warnings? Or will this creeping, crawling-up bull market give way to an exploding bull market?" And I answer, "Markets that continue to push relentlessly but cautiously higher generally end up with explosive action; they usually end by 'blowing off' on the upside amid surprise and excitement." So again, I ask myself, "Will the current action give way to a final unexpected parabolic surge to the upside?" It could happen, and the following paragraphs tell you why it could happen.

(1) I've learned to think of markets in terms of the unexpected. So I ask, "What would be the most unexpected thing this market could do?" In other words, what would constitute the biggest surprise to the greatest number of people? My answer -- a major market surge to the upside -- an explosion.

(2) Why do I say that? Well, for months the analysts have been warning that the market's action is ragged, that we haven't had a 10% correction in three years, that the stock market is grossly overvalued, that the first quarter of '94 will be a disappointment, that this is an area in the "presidential cycle" where the market tends to run into trouble, that Clinton's new taxes will come as a shock and depressant to investors, and on and on.

In other words, investor sentiment is geared for trouble. When investors have prepared themselves for certain events, those events are usually discounted by the market well in advance. For this reason, I believe that the market has already discounted any trouble that may lie ahead, at least for the foreseeable future.

(3) The D-J Averages have been hitting new highs after new highs. Last week the broad NYSE Composite confirmed (went to new highs) as did the S&P 500, the Value Line Composite, and the MidCap 400.

The action on the upside hasn't always been pretty (often only two or three Dow stocks will put the Dow at new highs) -- nevertheless, the various averages have continued to see-saw to new record highs. A market that continues to creep higher won't creep forever. The odds are that at some point the creep will give way to exciting upside action.

(4) The advance-decline ratio (a proxy for the entire market) broke down during October-November, but more recently the A-D has been pushing impressively higher. Based on its recent action, it would not surprise me to see a new high on the A-D over the next few weeks. Technically, of course, that would be very bullish.

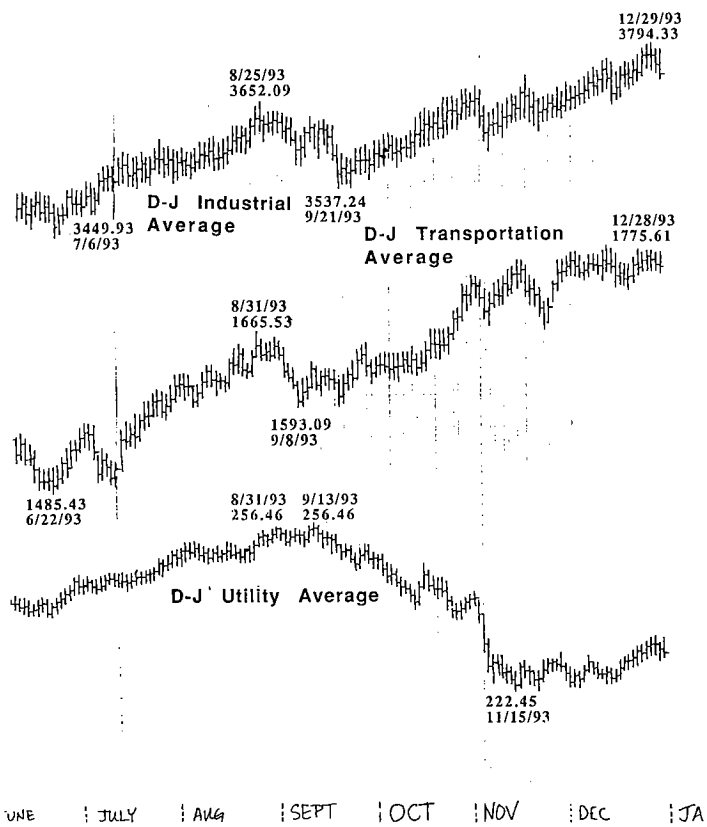
(5) A major factor in my thinking has been the action of my own Primary Trend Index. The PTI continues to climb to new record highs. The climb has been relentless, and it shows no indications of reversing. The continuing rise of the PTI places powerful pressure on the market to move higher (see page 2 chart).

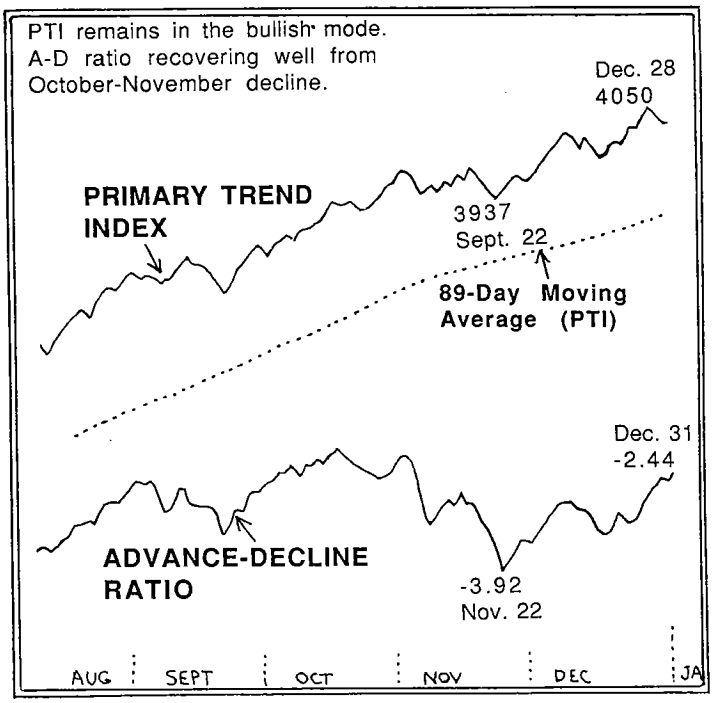
(6) In November margin debt on the NYSE rose to $59.8 billion, an all-time high. Despite what you may have heard, this kind of margin action is bullish. Historically, the trend of margin debt correlates with the trend of the market. As margin-using speculators continue to expand their positions, this exerts a powerful bullish force on the market. Forget what they're saying, pay attention to what they're doing. What are margin-using speculators doing? They're buying.

(7) Credit balances in brokerage accounts continue to expand. This is a bull market condition. It means that instead of emptying out their accounts by buying stocks, customers are allowing cash to build up in their accounts. When customers are really bullish, they spend much of their spare cash. Expanding credit accounts suggest that despite huge mutual fund buying, brokerage customers are still evidencing a degree of caution.

(8) The Negative Volume Index (NVI) continues to climb. This is an index based on what the market does when volume on one day is below the volume on the preceding day. A rising NVI correlates closely with bull market conditions.

(9) The money supply figures are beginning to look bullish. M-3, the broad money supply measurement, is finally expanding, suggesting that business is picking up, maybe picking up strongly.

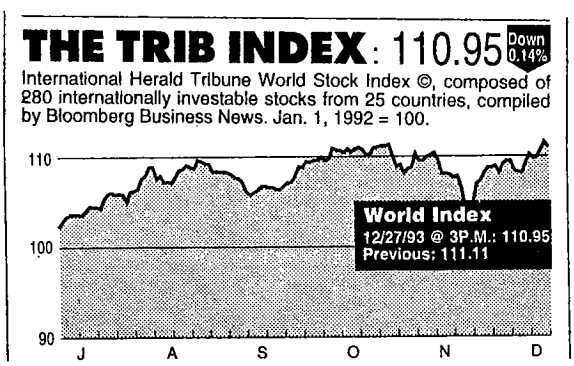




(10) The uncovered short interest positions on both the NYSE and the NASDAQ have hit record highs. Considering all of the above and considering that the bears have already taken a major beating, it is astounding that so many are still willing to risk so much on the possibility of this market collapsing. A record high short position in a bull market is bullish.

(11) The commodity markets are heating up and heading higher. The base metals (tin, copper, lead, aluminum, zinc) are moving higher as are gold and silver. Last week lumber struck a record high of over $500 per thousand board feet. The grains are all in bull trends. Last week the CRB Commodities Futures hit a three-year high. All this feeds the "inflation syndrome." Financial assets continue to rise (but tangible assets are now rising as well).

(12) World stock markets are "hot" with many hitting new record highs and a few such as Hong Kong and Mexico seeming to "blow off." This could be hinting at a totally unexpected "world boom" (could stock markets all over the world be wrong?). Furthermore, this kind of global stock market action provides a positive background for a blow-off in the US market as well. I show below the *International Herald Tribune's* World Stock Index. It's at its highest point of the year and looks as though it wants to go higher, maybe a lot higher.



(13) The following is extremely important. I'm well aware that the stock market is overvalued. I know that we've seen a lot of sloppy market action. I know that the bear arguments (many of them excellent arguments) are a dime a dozen. *But still this stock market stubbornly refuses to accommodate the bears. If a market won't go down, it's going to go up. But how long can this market continue to creep up? How long before the creep turns into a surge?*

The Dow is currently yielding a very low 2.68%. History tell us that when the Dow yields less than 3%, it's in "dangerous territory." At a 2.68% yield, the Dow and most stocks are now in what I would term "crazy land." The market may be crazy now, but we know that ultimately the stock market always returns to sanity. Which is another way of saying that, in due time, the stock market will return to a level where investors are receiving fair value and a decent return on their investment.

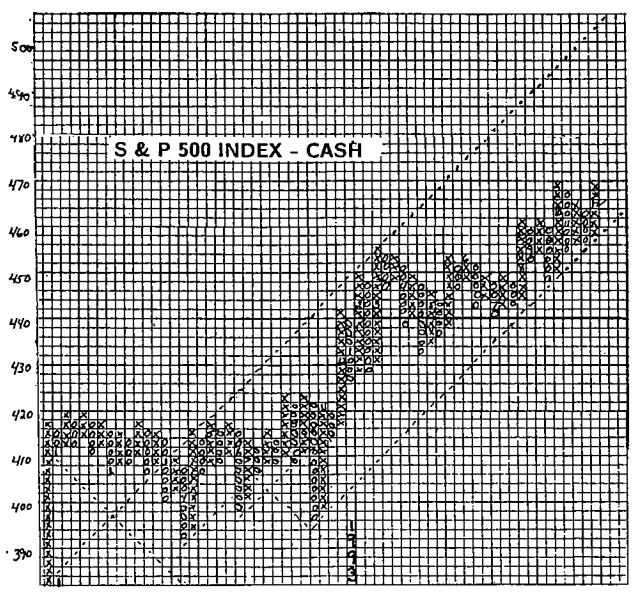
But the big question -- how will this "return to sanity" come about? And this is the possibility I've been suggesting -- the market will first "blow off" on the upside. It will surge to higher levels, shocking everyone and finally, finally, running the short sellers out en masse. To run the shorts out, the stock market will rise to utter extremes, beyond anything that the experts, the bulls, the optimists, now envision.

After that, and only after that -- will a ghastly primary bear market arrive.

Now consider this. 1993 was one of the lowest volatility years on record. In terms of percentages, the major averages did very little during 1993. *But after the calm comes the storm.* And I believe the year 1994 could see the storm -- both on the upside and on the downside. But first -- the upside.

ACTION: What if the Russell fantasy above comes to pass? How would you protect yourself on the upside? Here's an idea -- you can go out and buy call options on the S&P. The S&P is now priced at about 470. Let's say you want to protect yourself on the upside, to about 6% above current S&P levels -- to a value of 500 on the S&P. It costs you roughly $150 for a March 500 call (this call expires on the third Friday in March). Each call on the S&P is worth 500 times the price of the S&P. So if the S&P rises to over 500 before the end of March, you've got a call on over $250,000 worth of S&P stock.

Now let's say you're bearish, and you want to protect yourself on the downside. You want to protect yourself to around 6% on the downside in terms of the S&P -- to about 440. The price on a S&P put option at 440 is around $1200. In other words, for protection on the upside at S&P 500 it only costs you $150 for a call. But protection on the same percentage distance on the downside costs you $1200. Conclusion: Investors aren't thinking in terms of upside protection, but they are protecting themselves against the downside, and the prices of the puts (expensive) as against the calls (cheap) prove it.



The point & figure chart on page 2 shows the S&P 500 from 1992 to the present. Note that during most of 1992 and all of '93 the S&P has held within the confines of a rising channel. At 472 the S&P would break out to a new box high. It would then be possible (even probable) that the S&P would move up to make contact with the upper limit of the rising channel. To do this, the S&P would have to hit a level of 500 or above. Just a thought, dear subscribers, just a thought (chart courtesy of *Chartcraft,* New Rochelle, NY 10801).

OK, the Russell wind-up: I think there's a fair chance that this market could blow-off on the upside. It may not be a probability, but it's a possibility. SO, if you want to speculate on this possibility, you might buy the S&P March 500 calls. Remember, on a call you risk the full price of that call, and you're working against a time limit. But you do have that BIG leverage.

INVESTMENT POSITION: Why beat around the bush? I could give you the usual long list of "stocks to buy for '94" (every advisory service does that). Here's a novel idea, maybe I should just tell you what I personally have done or how I'm positioned. In other words, "Skip the babble, Russell, what have you actually done yourself?" First, I have a load of gold stocks. I have American Barrick, Pegasus, Placer Dome, Homestake, Newmont Gold, Agnico Eagle, Royal Oak, Hemlo, Horsham, Echo Bay, Euro Nevada, Franco Nevada (the last two on the Toronto), and Cambior (Montreal). I also have gold calls, the 380s and 400s of April and the 420s of June.

As for the stock market, I'm pretty much out of stocks (except the golds), but I am positioned for the possibility of a first quarter blow-off -- the potential explosion on the upside that I talked about in the first section of this Letter. Here's what I did, I bought a big batch of the March 500 S&Ps. So if the S&P roars up near to, or above 500, I'll be a happy person. If the S&P never gets anywhere near 500 during the first quarter I'll be a grouchy person. My wife, Faye, is hoping the S&P will sky-rocket to 600 by March. If that happens (slim chance), she'll get a bouquet of roses, an expensive dinner and who knows, maybe a new car.

NOTES & QUOTES: For those who buy the Dow stocks on a yield basis, here are the current top yielders: Woolworth, 5.15%; Texaco, 4.93%; Exxon, 4.59%; Philip Morris, 4.49%; Chevron, 3.86%; Union Carbide, 3.68%; DuPont, 3.66%; JP Morgan, 3.43%.

* *

Most people don't realize what the implementation of GATT will actually mean. If GATT is approved, then starting in 1996, hundreds of billions of dollars in government contracts will be open to international competition for the first time. The agreement will cover both national and state-level government contracts as well as utilities such as water and electricity. Furthermore, the agreements will expand tenfold the coverage of contracts open to international bidding. The GATT agreements will apply to the 12 European Union member states and 11 other countries ranging from Japan, Hong Kong and Korea to the European Free Trade Association countries, Canada and the US. Under the agreement foreign suppliers must be given the same treatment in government procurement as domestic suppliers. Will GATT increase business and employment in the US? We'll see.

* *

Walter Annenberg inherited a fortune from his dad. He bought *TV Guide* and built it into the largest circulation magazine in the US, all the while amassing an even greater fortune in other areas. A few weeks ago Annenberg gave away $500 million in a series of grants for school reform projects. This was the largest educational gift in US history. I don't know why, but this cynical thought came to me -- the largest educational gift in US history is equal to half a day's worth of US federal deficits. There's something very sick somewhere.

* *

Loss of Faith

As Cynicism Becomes An Industry, Distrust Of Washington Grows

Digging Dirt Is Now Called 'Opposition Research'; Voters Believe No One

Hot Rhetoric, Cold Cash

By John Harwood and Rich Jaroslovsky
Staff Reporters of The Wall Street Journal

The *WSJ* (Dec. 20) notes that Americans have grown cynical about their government. That should hardly be surprising to the *WSJ* or its readers. After all, we've mortgaged our future, we've driven the dollar down to where it's lost 90% of its 1945 value, crime is rampant throughout the nation, and every city, large or small, now harbors its army of homeless. So why shouldn't Americans be growing cyncial?

One reason Americans have grown cynical about government is that they feel overwhelmed and helpless in the face of endless stupidity and sleaze out of Washington. A typical example, to my mind, is the income tax. According to a new Tax Foundation study -- for 90% of US corporations (that is, companies with less than one million dollars in assets) the total cost of complying with the 1990 federal income tax code exceeded their income tax liability by 390%. As far as big business is concerned, studies by the Univ. of Michigan show that compliance by the Fortune 500 cost those companies $1.055 billion. This, of course, doesn't take in the multi-billion dollar cost of running the IRS itself. The fact is that a national sales tax of 20% would more than cover the nation's needs. Two main objections to a national sales tax -- it would virtually eliminate the monstrous, ingrained tax industry. And a national sales tax would show consumers what they are actually paying for big government (as government expenses increase, the national sales tax would rise).

* *

Back to sleaze -- readers must know by now that I'm not a big Bill and Hillary fan. I've felt Bill was sleazy ever since I read the Genifer Flowers interview in *Penthouse* (an article about the Clinton-Flowers 12-year relationship). The interview most definitely had the ring of truth about it. Then the recent report from the two security guards about Clinton's meeting with various women -- the ring of truth again. To me the big mystery is why Hillary puts up with it? My guesses: (1) She's in total denial, (2) Bill and Hillary remain friends, but their "interests" lie in other directions, (3) Hillary puts up with Bill because she loves the power of being First Lady. In the end, Clinton is a Jack Kennedy wan-a-be, and he's doing the whole routine from liberalism in politics to liberalism in his sex life. Both Bill and Hillary are highly intelligent, but I believe that Hillary is the brainier of the two. The only problem is that Hillary's brain is centered somewhere back in the 1960s. As for the problems of the 1990s, Hillary doesn't have a clue.

* *

While I'm in my vitriolic mood, there's Larry King. Honest, I was a very early King fan, back in the early radio days when Larry would tell humorous stories about his boyhood in NY and when he didn't take himself so seriously. But King is basically a muddle-headed liberal and a bore. Today, King firmly believes he's the "king-maker," and he's now insufferably full of himself. Do you read his column in *USA Today?* King has become such a disgusting name-dropper that I shake my head in disbelief whenever I read his column.

* *

Chelation (pronounced key-lation): While I was at one of my two hour chelation sessions, I had a long talk with a psychologist whose job it is to counsel cancer patients. He told me that there's a definite cancer personality. The cancer personality is a person who is very "good," very conscientious, very duty-bound, but a person who doesn't know how to have fun. The cancer personality tends to live through other people, sometimes through their own children. But basically they are out of touch with their emotions. The psychologist told me that this type of person tends to be

passive, is not a "survivalist." When you're having fun, he went on, your emotions are stirred, and your juices flow. All this strengthens the immunity system. I told the doc that I had always termed cancer "the disease of resignation." He agreed. He said many cancer patients quickly resign themselves and are passively ready to die -- the opposite of fighters and survivalists.

So, the Russell advice. Have fun. Work at something you enjoy. The fact is that if you enjoy it, it really isn't work. Personally, I like work better than I like vacations (which is probably why I have to be forced by Faye to take a few days off every once in a while). So, find out what you get a kick out of -- and do it. Stop letting other people tell you that "it won't work." If it doesn't work, so what, you tried. Get into what you're enthusiastic about. You have an absolute right to. I don't care if it's cars, religion, collecting shampoo bottles, golf, starting a business, anything that's not destructive to yourself or to other people. All great men, all successful men, act out their passion. (And when I say men, I obviously mean women too -- see, I can be politically correct if I have to.)

* *

The Saudi economy is over a barrel. With oil now under 15 bucks a barrel, the Saudis are running big deficits (this is their eleventh year of deficits). With Saudi reserves down to $5.9 billion, observers say that the Saudis will have trouble covering their domestic needs, paying for costly imports and servicing their debts. For the US, the BIG problem is that the Saudis may cut part of the $35 billion in military orders that are on US books. To many US suppliers, the Saudi orders are a lifeline. And despite what Washington says about peace and a lowering of world armaments, the US continues to push all-out for arms sales throughout the world.

Oil observers believe that a decade from now world oil needs will be 15% to 20% higher. That means the Middle East oil production will rise from 18.3 million barrels a day to 28 million a day. The Saudis stress that they are sitting on 300 billion barrels of oil, 25-30% of the world's proven reserves, oil reserves that can generate anywhere from 3 to 5 trillion dollars.

* *

President Clinton announced two weeks ago that he's going to reduce the federal deficit to below $200 million for the next fiscal year. So far, looking at the monthly deficits, I don't see it. Part of the fudging (lying) on the federal deficit figures is due to the fact that the government "borrows" from the Social Security Trust, and they use this borrowing to reduce the debt figures. At any rate, readers know that the statistic I watch is the one that can't be fudged. That figure is the actual 12-month addition to the federal debt. The latest weekly total for the national debt is $4,484.7 trillion, whereas exactly one year ago the total was $4,138.1 trillion. The addition to the federal debt over the last 12 months was $346.6 billion. This is the true size of the deficit.

* *

Did you ever wonder why women have taken all the garbage and nonsense from men over the centuries? Men got away with it (they still do, of course) because (1) men are physically stronger than women, they can physically overpower women, and (2) men are naturally hunters, they are aggressive, while women are naturally nurturers, they are peace-makers, they are the bearers and raisers and comforters of children (in nature, many female animals have to protect their young from predatory males).

But times are changing; women in many parts of the world are gaining the vote and consequently gaining their rights. My guess -- we'll have a woman president in the US within 25 years, maybe sooner. The big change -- women are perceiving themselves differently, and that's the key. Oh yes, check the roster of any freshman class of would-be lawyers. Half or more are women. And in law there is power.

* *

Hey California, how're we doing? Well, not that great. The coming '94 state deficit could easily hit $4 billion, and then there's '95 and '96 to deal with. All of which means a cut in services and employment in the Golden State. I don't think they can raise taxes any higher here, can they?

'94-95 shortage forecast as $3.8 billion or higher

By ED MENDEL
Staff Writer

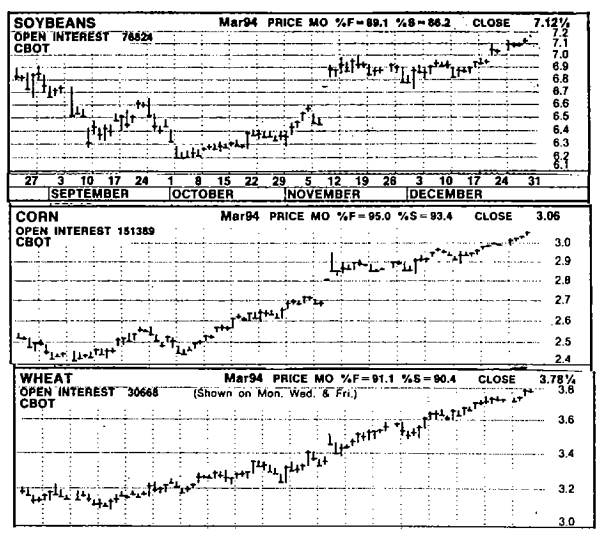
SACRAMENTO — In a bleak forecast, the Commission on State Finance said yesterday that the state faces another budget gap next year of at least $3.8 billion, or perhaps much more, and will continue to have major budget shortfalls for several more years.

* *

Bill Gary writes in his excellent *Price Perceptions* [(800)231-0477], *"It is now conventional wisdom that major bull markets do not occur in commodities. Even industrial users of commodities no longer buy ahead or build inventories in anticipation of possible shortages. In fact, the winning investment strategy of the decade has been to bet against higher commodity prices and inflation. The last time economists and investors held a similar consensus was during the early '70s. A decade of chronic surplus and low commodity prices ended abruptly in 1972-73. Soybean prices advanced from $3.50 in 1972 to $13 in 1973 . . . We have just experienced another decade of chronic surplus and low commodity prices. Commodity market complacency has never been greater."*

Russell comment: Bill Gary is making some very important observations here. He concludes, *"The prelude to commodity shortage is as evident today as it was in 1972. But nobody is paying attention. The winds of change are blowing at gale force . . . don't be caught at full sail!"*

I fully agree. It's like an economists' chorus, "No inflation, no inflation." But as I've been pointing out for months, the charts disagree. It looks like we've got a real demand-side bull market going in commodities and particularly in the grains. A demand bull market is one in which the supply is limited and the demand increasingly overwhelms the supply. This type of bull market in commodities hasn't happened in a decade, and most traders don't know what a big-demand bull market in commodities even looks like. They may find out this year. Here are a few grain charts from *Investor's Business Daily* (by the way, daily circulation for this fine newspaper is at a new high of 177,000).



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In 1990 20,000 US deaths were attributed to drug use. During the same year an estimated 100,000 deaths were caused by alcohol and 400,000 deaths were caused by tobacco-related diseases. Yet tobacco and alcohol are legal and drugs are illegal. I always say that *in the end economics wins*. The cost of the war against drugs is staggering -- the *Fortune* estimate is that federal, state and local authorities will spend $30 billion to imprison 1.4 million people and then they add another $5.5 billion for construction and

upkeep of more prisons if Congress approves the new anti-crime bill. For this reason alone, I predict that it's a matter of time before drugs are decriminalized. US jails are chocking with drug-offenders in for long prison terms. And we've got literally a whole generation of young blacks in prison. I don't think this can go on. It's too expensive; it's too insane.

* *

What were the top-grossing show biz acts for 1993? Would you believe -- at the top were the Grateful Dead (still going strong after all these years). With 78 shows, the Dead pulled in $44.5 million in '93. Second was Paul McCartney at $32.3 million, Rod Stewart at $19.9 million, Bette Midler at $18.8 million, Garth Brooks at $18.7 million, and Neil Diamond at $18.6 million.

* *

New York magazine just included about 25 letters from prominent New Yorkers -- each letter discussed what they liked and what they didn't like about the City. The commonest dislike -- literally tripping over the homeless that were everywhere. Every major city now has its army of homeless. It reminds me of my youth during the Great Depression, when I would see the "Hoovervilles" (shacks made of boxes, crushed tin cans or old boards) situated in Central Park or on the West Side or on the banks of the Hudson River. One of my greatest frights as a child was climbing up some rocks in Central Park. In one large rock there was a little cave where I used to play "hide and seek" with some friends. One day I crawled into the cave, and suddenly I was face to face with a wild-eyed homeless man who was glaring at me. It scared the heck out of me, I can still see those blood-shot eyes.

A report by the nation's mayors out two weeks ago noted that demand for shelter for the homeless is up 10% over '92, and the percentage of homeless families needing shelter increased to 43% up from 32% last year. The report states that nearly half of the homeless are substance abusers, while 27% are mentally ill (my guess is that 80% of the homeless are mentally ill). Veterans make up 21% of the homeless. Most of the cities surveyed had to turn away homeless people and families because of lack of resources.

* *

The pressure for gun control is reaching epic proportions, and most of the politicians are doing a grand-standing act. They think that making it much more difficult for honest citizens to own guns will solve the problem. My answer -- gun registration, raising ammo prices, gun safety courses won't make a dent in the mayhem that is sweeping this nation. Criminals don't buy guns in gun stores, only honest people do.

Let's face it -- the level of frustration in the US is rising. The frustration and anger is due to families falling apart, the problem of uneducated people (and there are millions of them) finding jobs, the public's anger with government stupidity, the sliding standard of living in the US, and the rising cost of living. All of this militates towards violence. And violence is as American as mom and apple pie.

But the pressure in on, and the politicians have to say something. So they're saying that making it harder for law-abiding citizens to own guns is going to "do something." It won't. The problems are social and moral, and Washington has yet to solve its own social and moral problems. Speaking of Washington, DC has some of the toughest anti-gun laws in the nation. DC is also the "murder capital of America." Has any pol brought that up yet?

* *

Numbers: What actually happened during the rather boring (for stocks) year 1993? The **Dow** ended the year 1992 at 3301.11, while it ended 1993 at 3775.88 -- for a total gain of 474.77 points. The much broader **S&P 500 Composite** ended the year 1992 at 435.71 -- it ended the year 1993 at 468.64, for a total gain of 32.93 points. The market climb was gradual with no major corrections, which probably explains why there was no great excitement over stocks during 1993 . . . **Gold** ended 1992 at 333.10 per ounce. Gold ended 1993 at 390.80 -- for a total gain of 57.70 or 17.3%, more than twice the gain in the S&P 500.

* *

The world is shocked and frightened by the rise of Vladimir Zhirinovsky -- he captured 25% of the Russian parliament seats. Prior to the election, Zhirinovsky made all kinds of wild statements from, "We'll nuke Japan if they don't give us back the Kurile islands," to threatening "to take back Alaska." But after his election triumph, Zhirinovsky calmed down and said he was a friend to all nations. The "inside word" is that Boris Yelstin is only too happy to have Zhirinovsky as his competitor. Yeltsin believes that in a face-to-face run-off election, he can beat Zhirinovsky. Reason, Zhirinovsky is a Jew and was active in Jewish affairs (his father was a Jew), he's a reputed bi-sexual, and he appears at times to go off the deep end. So according to Yeltsin, there are three strikes against Zhirinovsky (for my Jewish readers, you must know by now that Jews are not popular in Russia).

The Russell view: I'm not convinced that everything will work out for the best in Russia. Remember, the Russians have lived in non-democratic societies for over 1,000 years. They have had no experience with democracy. Furthermore, I've received letters from people who have traveled across Russia and the word is that aside from the military, Russia's a third world country. Nothing works, nobody works, the state of their factories is abysmal, and the inefficiency, the laziness, the crime, are everywhere. I don't know what it will take to turn Russia around. I don't know whether it can be done. In the meantime, the Communists, the super-nationalists, the neo-Nazis, the right wingers, the anti-Semites, are gaining strength. Let hope the crazies don't again take over Russia. To me the greatest potential menace in the world today is Russia.

* *

The world's largest hotel, the MGM Grand, opened in Las Vegas a few weeks ago. The hotel has 5,005 guest rooms, parking for 9,000 cars, four movie-themed towers, 93 elevators, a special events facility that can seat 15,200, a swimming pool the size of three football fields, a 171,000 square foot casino replete with 3,500 slot machines and 165 gambling (oops, gaming) tables, nine restaurants with a buffet room than can seat 1,000. Most incredible of all, the hotel was completed on time and on budget. As someone said, "It's amazing what a billion dollars will do." Which is just what the MGM Grand cost.

* *

Sindlinger & Co. (Wallingford, Pa. 19086) writes, "Can you believe that the government's current consumer spending deflator is near 1% on a year-to-year basis, while the durable goods consumer spending deflator is growing by 0.4% on a year-to-year basis?" *Sindlinger* then states that his "Consumer Cost-of-Living Index, measured daily, is growing at over 8% on a year-to-year basis." Russell comment: I don't know about the government's nonsense figures, but I do know that my own living costs are growing by at least plus 8% on a year-to-year basis (and that doesn't include the Clinton boost in federal taxes).

* *

The following is from a letter just received from a subscriber in Sweden (this subscriber is now moving to Milan): "After six years in Scandinavia, we finally saw the fjords, which deserve their reputation. Happy memories of Sweden center on beautiful (but monotonous) scenery, friendly (but morose) people, whose favorite two pastimes seem to be getting drunk and standing in line, the world's most courteous bureaucrats, a clean and relatively safe environment, Baltic cruises, excellent fish (the one bright spot in the worst cuisine we have experienced). We won't miss the $150 parking tickets for trivial offense, or the cloudy/cool or cloudy/cold weather. Italy, too, is expensive, but the $50 which buys a snack in Sweden buys a feast here . . . We go from one country in the midst of a severe crisis to another. The fall of the USSR affected all of Europe, nowhere more than here (Italy), where the renamed Communist Party just won the city hall in most major cities -- on a Capitalist platform! . . . Europe searches for a way to break the news that the welfare state party is over, with no longer enough money for the kind of health care program that Clinton proposes for the USA."

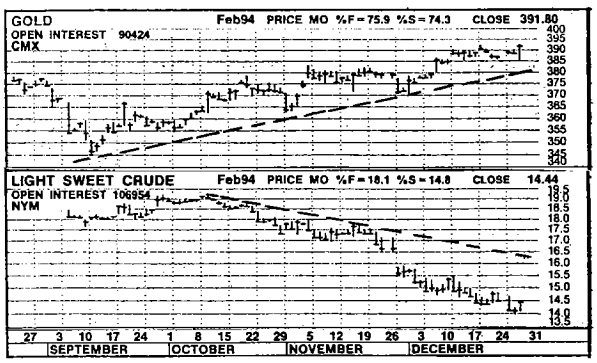
GOLD: The most difficult part of making money in a bull market is in the exercising of patience. The bull will try every trick in the books to take you out. Corrections, frightening rumors, sudden swoons in the price action, long, dragged out, boring periods where nothing happens, unexpected but temporary bad news --

you'll experience them all in every big bull market. And each and every one of the above is calculated to take you out of your positions.

That's about what has happened to gold since early in '93. This is the hard part. Each 10 dollar increment has been almost tortuous to overcome. First get above 360, then 370, then more recently 380, and now the struggle to get above and stay above 390.

One of the extraordinary facets of the recent gold action is that it took place in the face of a collapse in the price of oil. When oil ("black gold") caves in, as it has, this is generally accepted as a deflationary omen. Therefore, swooning oil prices tend to put pressure on the price of gold.

So examine these two charts, courtesy of *Investor's Business Daily*. Gold has actually moved up in the face of a broad smash in the price of oil. The last time this happened (oil down and gold up) was six years ago in 1986. So I do feel that gold would now be considerably higher had it not been for oil's collapse in 1993. On the other hand, you have to wonder what will happen once oil bottoms and turns up again (note by the way, that the big oil stocks have remained quite strong).



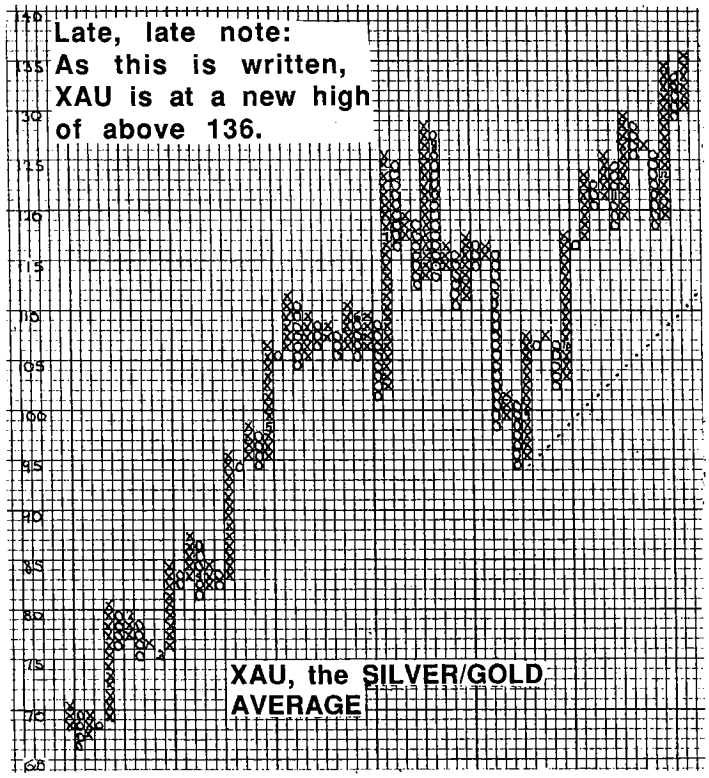
All in all, I take gold's performance in the face of the oil smash as a definite sign of strength. When an item doesn't act "the way it's supposed to," the market is telling you something. The 1993 action of gold versus oil is telling us that gold is in a strong, solid bull market.

One note about gold's supply/demand situation. Russia has always been a big supplier of gold (second only to S. Africa). More than half of Russian gold production comes from two areas, the Magadan and Sakha republics. But this year these republics received less than half of their fuel from Mosow and only 30% of their food. For this reason, Russian gold production will be down roughly 30% in '94 . Furthermore, Russia has already sold gold down to its stockpile, and any further sales of gold will have to come out of actual production. All in all, expect Russian inefficiencies and troubles to reduce the world gold supply by a substantial 50 tons or more this year.

The point & figure chart of gold (courtesy of *Chartcraft*) is worth studying. The last row of O's on the chart took gold down to the 344 box. Since then the gold price has recovered more than half of the decline. When this occurs, the ODDS favor a continuation of the rise and a test of the high. In this case the high was the 404 box recorded last August.

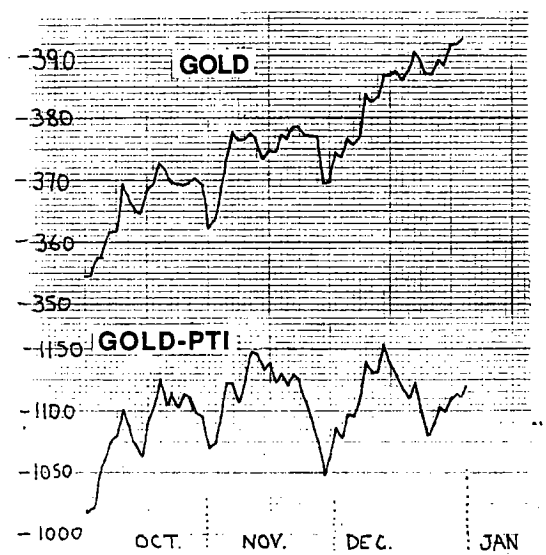
An upside breakout would entail a price of 408 on London gold (second fix). If that happens, I would take it as a definite sign that the gold bull market was resuming -- and I would expect sharply higher prices all around for gold, gold options, gold stocks, gold coins. In the meantime, PATIENCE.

From the precious metal stock side of it, XAU, the Philadelphia Silver/Gold Average (it does not contain ABX) should be studied. Here we see my P&F chart of XAU during 1993 and to the present. The August-September correction, which took XAU down to 96, was completely retraced on the upside, and during December XAU rose to a recovery high of 135. From there XAU backed off



again, so that the new upside target and bull breakout would now be 136 or better. To sum it up, XAU presents a bullish pattern.

Finally, we see gold (nearest contract) pushing up to a high above 390. We also see my Gold Primary Trend Index (G-PTI) making a new high of 1153 on December 13, then backing off into late December. Despite the better action in gold itself, G-PTI has not confirmed on the upside. I would expect hesitation and erratic action in the gold stocks until we get a new recovery high in G-PTI. But remember -- the primary trend of gold is bullish. That's the operative fact.



LATE NOTES: The broad S&P 500 moved (highest point to lowest point) only 11.9% in 1992 -- that represented the lowest volatility in 60 years. But get this -- 1993 set a new record for low volatility, a total S&P move of **only 9.8%.** My guess -- a change coming -- 1994 will provide BIG volatility (could it be a major rise and a major fall?). My wife, Faye, had a premonition. She thinks people are tired of being careful and worried and will spend their heads off on higher-priced merchandise in '94. I tend to agree with her. But all things considered, I'm continuing to bet on gold.

NEXT MAILING: Jan. 19, 1994